

# CLARIFICATION OF LIMITATION ON POSSESSION TAXATION OF GOVERNMENTAL PENSION INCOME

SEPTEMBER 8, 1999.—Committed to the Committee of the Whole House on the State  
of the Union and ordered to be printed

Mr. GEKAS, from the Committee on the Judiciary,  
submitted the following

## R E P O R T

[To accompany H.R. 462]

[Including cost estimate of the Congressional Budget Office]

The Committee on the Judiciary, to whom was referred the bill (H.R. 462) to clarify that governmental pension plans of the possessions of the United States shall be treated in the same manner as State pension plans for purposes of the limitation on the State income taxation of pension income, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

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## PURPOSE AND SUMMARY

H.R. 462 makes technical corrections to section 114 of title 4 of the United States Code.

## BACKGROUND AND NEED FOR THE LEGISLATION

On February 2, 1999, Representative George W. Gekas (R-PA) (for himself and Representatives Bill McCollum (R-FL), John Mica (R-FL), and Carlos Romero-Barcelo (D-RC-PR)), introduced H.R. 462.

H.R. 462 makes two technical corrections to section 114 of title 4 of the United States Code, which was enacted in 1996 to restrict the ability of States to tax certain types of pension income received by their former residents.<sup>1</sup> Section 114 is intended to protect income received from “qualified” pension plans (as defined in the Internal Revenue Code) as well as income received under certain “non-qualified” retirement plans, subject to certain specified conditions.<sup>2</sup> In pertinent part, section 114(a) prohibits a “State” from taxing “retirement income” of its former residents, including income from a “governmental plan,”<sup>3</sup> which section 114(b)(1)(G) defines by reference to section 414(d) of the Internal Revenue Code.<sup>4</sup> Section 414(d) of the Internal Revenue Code, in turn, defines a “governmental plan” as a plan established by the Federal government, State government or any political subdivision thereof.<sup>5</sup>

Although section 114(b)(3) specifies that “State” includes “possessions of the United States,” the Internal Revenue Code does not define “State” as including either “possessions of the United States” or the Commonwealth of Puerto Rico.<sup>6</sup> Instead, the Internal Revenue Code generally defines possessions of the United States as including the Commonwealth of Puerto Rico.<sup>7</sup>

As evidenced by its literal wording, section 114 was intended to apply to “possessions of the United States.”<sup>8</sup> Nevertheless, the provision’s incorporation of the Internal Revenue Code’s definition of “governmental plan” (which neither includes possessions of the United States nor Puerto Rico) creates an anomaly that effectively excludes retirement plans established by possessions of the United States. As a result of section 114’s internal inconsistency, Puerto

<sup>1</sup> Pub. L. No. 104–95, 109 Stat. 979 (codified at 4 U.S.C. § 114 (1996)).

<sup>2</sup> H.R. Rep. No. 104–389, at 2 (1995). As the Committee’s report accompanying this legislation explained:

The purpose of H.R. 394 is to prohibit State taxation of certain retirement income of a nonresident of the taxing State. It would protect all income received from pension plans recognized as “qualified” under the Internal Revenue Code. It would also exempt income which is received under deferred compensation plans that are “non-qualified” retirement plans under the tax code, but which meet additional requirements.

*Id.* at 2–3.

<sup>3</sup> 4 U.S.C. § 114(b)(1)(G).

<sup>4</sup> 26 U.S.C. § 414(d).

<sup>5</sup> *Id.*

<sup>6</sup> 26 U.S.C. § 7701(a)(10) (“The term ‘State’ shall be construed to include the District of Columbia, where such construction is necessary to carry out provisions of this title.”).

<sup>7</sup> 26 U.S.C. § 7701(d) (“Where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, references in this title to possessions of the United States shall be treated as also referring to the Commonwealth of Puerto Rico.”).

<sup>8</sup> See 4 U.S.C. § 114(b)(3).

Rico has taxed the retirement income derived from its former residents' governmental plans.<sup>9</sup>

In addition to remedying this technical error, H.R. 462 also corrects a typographical error. It changes the erroneous designation of subsection 114(e) to subsection 114(c).

In the last session, Representative Gekas introduced H.R. 4572, which was identical to H.R. 462.<sup>10</sup> Although the House, under suspension of the rules, passed H.R. 4572 by voice vote on October 15, 1998, the Senate did not consider it prior to the end of the 105th Congress.

#### HEARINGS

No hearings were held on H.R. 462.

#### COMMITTEE CONSIDERATION

On March 24, 1999, the Subcommittee on Commercial and Administrative Law met in open session and ordered favorably reported the bill, H.R. 462, without amendment by voice vote, a quorum being present. Thereafter, the Committee met in open session on May 19, 1999 and ordered favorably reported the bill, H.R. 462, without amendment by voice vote, a quorum being present.

#### COMMITTEE OVERSIGHT FINDINGS

In compliance with clause 3(c)(1) of Rule XIII of the Rules of the House of Representatives, the Committee reports that the findings and recommendations of the Committee, based on oversight activities under clause 2(b)(1) of Rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

#### COMMITTEE ON GOVERNMENT REFORM FINDINGS

No findings or recommendations of the Committee on Government Reform were received as referred to in clause 3(c)(4) of Rule XIII of the Rules of the House of Representatives.

#### NEW BUDGET AUTHORITY AND TAX EXPENDITURES

Clause 3(c)(2) of House Rule XIII is inapplicable because this legislation does not provide new budgetary authority or increased tax expenditures.

#### CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

In compliance with clause 3(c)(3) of Rule XIII of the Rules of the House of Representatives, the Committee sets forth, with respect to the bill, H.R. 462, the following estimate and comparison prepared by the Director of the Congressional Budget Office under section 402 of the Congressional Budget Act of 1974:

<sup>9</sup>See Letter from Carlos S. Quiros, former Secretary of State of Puerto Rico, to Reps. John Mica and Bill McCollum (Jan. 14, 1998) (on file with the Subcommittee on Commercial and Administrative Law of the Committee on the Judiciary).

<sup>10</sup>H.R. 4572, 105th Cong. (1998).

U.S. CONGRESS,  
CONGRESSIONAL BUDGET OFFICE,  
Washington, DC, June 25, 1999.

Hon. HENRY J. HYDE,  
*Chairman, Committee on the Judiciary,*  
*House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 462, a bill to clarify that governmental pension plans of the possessions of the United States shall be treated in the same manner as state pension plans for purposes of the limitation on the state income taxation of pension income.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contacts for this estimate are Mark Grabowicz (for federal costs), who can be reached at 226-2860, and Michelle Patterson or Lisa Driskill (for the state and local impact), who can be reached at 225-3220.

Sincerely,

DAN L. CRIPPEN, *Director.*

*H.R. 462—Clarify that governmental pension plans of the possessions of the United States shall be treated in the same manner as state pension plans for purposes of the limitation on the state income taxation of pension income*

CBO estimates that enacting this legislation would have no impact on the federal budget. Because the bill would not affect direct spending or receipts, pay-as-you-go procedures would not apply. H.R. 462 contains an intergovernmental mandate, as defined in the Unfunded Mandates Reform Act (UMRA), that applies to U.S. possessions. CBO estimates, however, that the costs would not be significant and would not exceed the threshold established in that act (\$50 million in 1996, adjusted annually for inflation). State, local, and tribal governments would not be significantly affected by the enactment of this bill. H.R. 462 contains no new private-sector mandates as defined in UMRA.

H.R. 462 would prohibit a possession of the United States from taxing the retirement income of individuals who are no longer residing in that possession. The bill effectively would apply to certain U.S. territories the provisions of current law that prohibit states from taxing such pension income. Based on information received from the territories, CBO has determined that Puerto Rico would be the only territorial government affected by this prohibition. As of last year, Puerto Rico stopped taxing the pensions of new retirees who move from the island. Puerto Rico was unable to provide data about the amount of revenue currently received from the taxed pensions of those who retired under the old system and moved elsewhere. CBO estimates, however, that because the number of retirees affected by this bill is likely to be very small, the losses to Puerto Rico would not be significant.

States that currently offer a tax credit to residents for taxes paid to other states or territories, particularly those that are popular retirement destinations, would realize an increase in tax revenue.

Like the costs, however, CBO estimates that such revenue increases would not be significant.

The CBO staff contacts for this estimate are Mark Grabowicz (for federal costs), who can be reached at 226–2860, and Michelle Patterson or Lisa Driskill (for the state and local impact), who can be reached at 225–3220. This estimate was approved by Robert A. Sunshine, Deputy Assistant Director for Budget Analysis.

#### CONSTITUTIONAL AUTHORITY STATEMENT

Pursuant to clause 3(d)(1) of Rule XIII of the Rules of the House of Representatives, the Committee finds the authority for this legislation in Article I, section 8 of the Constitution.

#### SECTION-BY-SECTION ANALYSIS

*Section 1. Clarification of Application of Limitation on State Income Taxation of Pension Income.* Subsection 1(a) of H.R. 462 amends subparagraph (G) of section 114(b)(1) of title 4 of the United States Code to clarify that governmental plans of possessions of the United States are to be treated as governmental plans of states for purposes of section 414(d) of the Internal Revenue Code.

Subsection 1(b) of the bill corrects a typographical error by redesignating subsection (e) of section 114 as subsection (c).

Subsection 1(c) specifies that H.R. 462 applies to amounts received after the bill's date of enactment.

#### CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman):

#### SECTION 114 OF TITLE 4, UNITED STATES CODE

##### **§ 114. Limitation on State income taxation of certain pension income**

(a) \* \* \*

(b) For purposes of this section—

(1) The term “retirement income” means any income from—

(A) \* \* \*

\* \* \* \* \*

(G) a governmental plan (as defined in section 414(d) of such Code) *or any plan which would be a governmental plan (as so defined) if possessions of the United States were treated as States for purposes of such section 414(d);*

\* \* \* \* \*

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[(e)] (c) Nothing in this section shall be construed as having any effect on the application of section 514 of the Employee Retirement Income Security Act of 1974.

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